Supreme Court, U.S.
FILED
OCT 26 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 88-302

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

JAMES A. GORDON, Special Deputy State Insurance Commissioner of Maryland and Receiver for Eastern Indemnity Company of Maryland,

Petitioner,

v.

UNITED STATES DEPARTMENT OF THE TREASURY, *et al.*,

Respondents.

REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

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October 26, 1988

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

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Petitioner James A. Gordon, Special Deputy State Insurance Commissioner of Maryland and Receiver for Eastern Indemnity Company of Maryland, respectfully submits this Reply to Respondents' Brief in Opposition. In accordance with Rule 22.5 of this Court, this Reply addresses only those arguments first raised by Respondents in their Brief in Opposition.[1]

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[1] This Reply does not, as a result of Rule 22.5, address the fundamental misunderstanding of the text, purpose and legis-

Respondents argue (incorrectly, we submit) that the instant Petition should not be granted because in *Idaho ex rel. Soward v. United States*, No. 87-4057, (9th Cir. Sept. 7, 1988), decided nearly three weeks after the Petition was filed, the United States Court of Appeals for the Ninth Circuit reached the same result as did the court below in a case presenting substantially the same question as is presented here. Respondents' Brief at 5-7. In fact, that case highlights the confusing judicial positions which must be resolved by this Court and counsels in favor of granting the Petition.

In *Soward*, the Ninth Circuit explicitly rejected the analysis adopted by the United States Court of Appeals for the Fourth Circuit below, and held that the analysis of this Court in *Securities and Exchange Comm'n v. National Securities, Inc.*, 393 U.S. 453 (1969) is the proper vehicle for interpreting the term "business of insurance" in cases arising under the primary regulatory purpose of the McCarran-Ferguson Act. Under the *National Securities* test, as employed by the Ninth Circuit, the focus is on "the relationship between the insurance company and the policyholder." *Id.* at 460. Significantly, the Ninth Circuit explicitly held that the test announced in *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979) and *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982) is inapplicable to a case arising under the McCarran-Ferguson Act's primary state

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lative history of the McCarran-Ferguson Act, 15 U.S.C. § 1011 *et seq.*, demonstrated by Respondents' Brief. Instead, Petitioner relies upon the analysis more fully developed at 10-18 of his Petition for an explanation of the invalidity of Respondents' arguments.

regulatory purpose.[2] The Ninth Circuit correctly recognized that because the *Royal Drug-Pireno* test is "tailored to address activities of insurance companies that would implicate the *antitrust laws* in the absence of the McCarran-Ferguson Act" (emphasis supplied), it is inapplicable to a case such as the one at bar.

The totally different approaches used by the Ninth and Fourth Circuits to resolve nearly identical questions exacerbates the already pervasive confusion surrounding what is meant by the "business of insurance" in the context of the McCarran-Ferguson Act's primary state regulatory purpose. A serious conflict, therefore, exists between the circuits. Significantly, many state statutes which the Ninth Circuit would hold regulate the business of insurance under the *National Securities* analysis, would be found to not regulate the business of insurance under the Fourth Circuit's *Royal Drug-Pireno* analysis.

For example, state insurance laws requiring that insurers make prompt payment after a covered loss and engage in good faith claims settlement practices[3] regulate the business of insurance under the Ninth Circuit's *National Securities* analysis because they directly involve the relationship between the insurer and the policyholder. However, such statutes do not regulate the business of insurance under the Fourth

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[2] Although the Ninth Circuit also employed the three-part *Royal Drug-Pireno* test as further support for its holding, that analysis was dicta and the court explicitly stated that the *Royal Drug-Pireno* test was not applicable. "*National Securities* and the legislative history alone are enough to decide this case without the three prongs of *Royal Drug*."

[3] *See, e.g.*, Md. Code art. 48A, § 230A; Va. Code § 38.2-510.

Circuit's *Royal Drug-Pireno* analysis because these same laws are unrelated to the underwriting or spreading of risk. This is because, according to the Fourth Circuit's *Royal Drug-Pireno* test, whether the policyholder's claim is ultimately paid upon the occurrence of a covered loss is irrelevant to the definition of "business of insurance" because the risk of loss is fully transferred once the policy is issued and the ultimate payment of a claim is "temporally unconnected" to the transfer of risk. Pet. App. at 18a-20a.

Furthermore, contrary to Respondents' suggestion, the Fourth Circuit's analysis directly conflicts with the result reached by this Court in *Federal Trade Comm'n v. National Casualty Co.*, 357 U.S. 560 (1958). Because insurer advertising is completely unrelated to the underwriting of policyholder risk, *National Casualty* would have to be decided differently under the Fourth Circuit's analysis. Significantly, *National Casualty* would be decided as it originally was under the Ninth Circuit's analysis because laws barring false or misleading advertising by insurance companies do involve the relationship between the insurer and the policyholder, and would therefore constitute the "business of insurance" for purposes of the McCarran-Ferguson Act.

More importantly, Respondents err in arguing that the statutes at issue in *National Casualty* regulated the business of insurance because advertising is "closely related" to the sale of insurance policies and, therefore, relate to the underwriting or spreading of risk, whereas, according to Respondents, the Mary-

land priority of payment statutes do not regulate the business of insurance. In fact, the Maryland statutes at issue bear a far stronger relationship to the transfer of policyholder risk because they ensure that policyholders are paid to the fullest extent possible. Accordingly, the Fourth Circuit's use of the *Royal Drug-Pireno* test in this context is in direct conflict with this Court's holding in *National Casualty*.

Additionally, contrary to Respondents' suggestion, the opinion of the Fourth Circuit also conflicts with the rationale underlying two Second Circuit opinions addressing insurance company insolvency proceedings. The broad language of the Fourth Circuit's holding that the Maryland priority of payment statutes do not regulate the business of insurance necessarily means that the policies of the McCarran-Ferguson Act simply do not apply to those statutes. This is inconsistent with *Levy v. Lewis*, 635 F.2d 960 (2d Cir. 1980) and *Law Enforcement Ins. Co. v. Corcoran*, 807 F.2d 38 (2d Cir. 1986), *cert. denied*, 481 U.S. 1017 (1987), which recognized that the McCarran-Ferguson Act's deferral to state regulation extends to the regulation of insurer insolvency.[4] The sweeping nature of the

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[4] Although the opinions in Levy and Corcoran dealt with the narrow issue of whether federal courts should abstain from exercising federal jurisdiction in federal actions involving insurance companies in liquidation, the analysis of these opinions makes clear that state regulation of insolvent insurance companies is part and parcel of the state's regulation of insurance, as to which there exists an express federal policy of non-interference. Levy, 635 F.2d at 963. Moreover, if, as suggested by Respondents, insurance company insolvencies do not involve the "business of insurance" because the company is no longer involved in the "business of insurance" once it loses its financial viability (Respondents' Brief at 7), the express exclusion by Congress of

Fourth Circuit's holding that the McCarran-Ferguson Act does not apply to insurer insolvency casts serious doubt on the continued primacy, if not future viability of state regulation of insurer insolvency.

All of the foregoing demonstrates the importance of the instant Petition. It is even more apparent now that the Ninth Circuit has spoken that there exists serious conflict among the circuits and between the decisions of this Court regarding the definition of the business of insurance in the context of the primary purpose of the McCarran-Ferguson Act. The confusion and likely potential for inconsistent results extends far beyond the confines of this litigation, as future cases arising under identical fact patterns will be decided differently, depending upon which decision is followed. Only this Court can clear up this confusion and authoritatively announce the test for the business of insurance in cases arising under the primary state regulatory purpose provisions of the McCarran-Ferguson Act.

Significantly, Respondents never quarrel with the fact that the issues at bar are of singular national importance and require prompt resolution. Indeed, Respondents' Brief is entirely silent on the point. As demonstrated by the *amicus* brief of the National Association of Insurance Commissioners, many insurance company insolvencies involving the claims of numerous policyholders are pending. The conflicting opinions of the Fourth and Ninth Circuits have cast a cloud of confusion upon these proceedings. There is, therefore, a compelling need for this Court to act in this area.

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insurance company insolvencies from the bankruptcy code makes no sense. 11 U.S.C. § 109(b)(2, 3).

CONCLUSION

For all of the foregoing reasons, the Petition for Certiorari should be granted.

Respectfully submitted,

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